CAPITAL MARKETS FUNDING - LEGAL DREAM OR NIGHTMARE?

RICHARD YORKE QC

Barrister, London

The choice of courts in which to commence proceedings is a subject of apparent dullness, yet it is vitally important, and one on which people have come unstuck many times. It is a fault of the Anglo-Saxon arrogance, which I am afraid has travelled to Australia, that we are so used to having a system of courts where, by and large we can understand what they are doing, and where the courts understand commercial processes, that we forget that this does not apply over most of the rest of the world. It doesn't apply anywhere where the civil law system runs which really means everywhere where English is not the first language.

To give you an example, can you imagine the problems that we had in the time of Mao Tse Tung with syndicated loans argued in French in Paris before a French court on what was the meaning of an English language contract governed by English law whereby US dollars were lent to the Chinese. And the Chinese speaking French are very difficult to understand. And the French courts anyway think they are doing rather well if it should get a judgment in five years. That is merely one example.

Another example (again this is more likely to happen in syndicated loans than it is with notes or bonds) is where you have inadvertently forgotten to specify the right law, the right courts, with the result that you have to litigate in the country of the man who owes you the money, and that happens to be one part of the Arab world.

In the Arab world you have very roughly two legal systems - one which is derived from the Egyptian which has always had the leading universities in the Muslim world, and that in turn derives from the French because that is one of the things that Napoleon left behind when he got there. But you also have the Islamic system. And if you end up in the Islamic courts and you are suing for damages, what you get is not what we think big enough to fill the hole in your pocket but what they consider is a sort of fine for the misbehaviour of the chap who did not pay. The difference is the fine is paid to you instead of to the State. There is often no relationship whatsoever to the sum of money involved but to the moral culpability of the failure to pay. Incidentally you do not get any interest by the court.

Those are examples of the danger you can get into. Now what you must do is to specify on the document what is the law that governs it. That simply has to be a law that you live with. Therefore issues out of Australia will normally be made in the law of the State of the issuing bank or the underlying issue whichever it is. You may choose for other reasons to make it different. You may decide that you prefer the fresh air in Perth at the time of the America's Cup than you do to the heat of Darwin. Well that is your choice, but at least choose where you are going.

You have one disadvantage which is unique to the common law system, viz that when you get into trouble you have to appear before a common law judge. All you have to do is to make him understand the law if he doesn't know it already from his previous practice at the Bar, perhaps read him the cases on the subject. Under civil law jurisdictions (which I haven't time to go into now) other things happen which are at times hair-raising.

The English law is quite clear that that submission to English law in itself is not a submission to jurisdiction. So you might find yourself with your Norwegian issuer arguing English law in a Norwegian court - a jaw breaking problem. Specify the court which is to hear the action.

Then there is rescheduling. You cannot reschedule a negotiable instrument. There is simply no way of doing it. Even if the instrument itself provides for rescheduling, that still will not do because there is no publicly available means whereby after rescheduling the debtor and borrower will both know precisely what has to be paid in order to discharge the note. This is not a subject which requires long explanation, it is simply that you cannot have a rescheduable negotiable instrument.

And of course so far as the rescheduling obligation is concerned in a note which does not provide for the rescheduling itself, this postulates an actual or contingent dishonour. What you are really doing is reaching a settlement with the defaulting borrower as to when he is going to discharge his liabilities. Most of it is done in order to save the faces of the bank whose balance sheets, if they disclosed the true position, would show they had a deficiency of assets. Unfortunately they would have difficulty in getting any more money off their customers; there are very few banks at the moment who have any exposure in South America whose balance sheets are not wildly optimistic to put it at a low level.

The advice to be given to trustees in these circumstances is the same as the advice given by Mr Punch to those about to marry - i.e. <u>don't</u>. It is virtually impossible for a trustee to exercise his discretion in a way which will satisfy everybody and therefore he is at risk of laying himself open to suit from somebody. He is also in a position that if the trustee is any bank or financial institution the Chinese walls will operate. Remember the Chinese wall is a thing that is full of chinks and

it is virtually impossible for man to put out of his mind, in exercising his discretion whether to agree to something, what he just heard down the corridor at lunch the previous day with one of his colleagues who has an interest on the other side.

There is grave difficulty, for, unless you employ specifically for the trustee department where they are custodian trustees, unless you employ people who are deaf and dumb and blind, and can only be communicated with by some extraordinary system whereby you can totally control the input to them, there is almost no way they can do the job. They may default because they can only consider the particular issue that they are concerned with is to take a decision which is the right decision for the particular fund that they are concerned with, but is hopelessly the wrong decision for the long-term interests both of the borrowers and the lenders. They will inevitably take a decision which is in itself self destructive over quite a short period of time. I am sorry that sounds rather philosophical but it is a quite real situation that there are constraints on a trustee as to what he can do and the information that he can rely upon.